IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 743

In The Matter of

INDIAN LAKE ESTATES, INC., Bankrupt,

ERNEST L. STEWART, Trustee in Bankruptcy,
Petitioner,

v.

UNITED STATES OF AMERICA, *Respondent.*

REPLY BRIEF FOR PETITIONER

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1. The Government Apparently Concedes That the Decision Below Makes the Priority Provision of the 1966 Bankruptcy Act Amendments Meaningless.

The Government argues that section 17(a)(1)(c) cannot be construed according to the general purpose of the 1966 amendments, for "as an exception [it] cannot comport with that objective." The Government's argument is disingenuous. Petitioner agrees that the exception must have substance, and has suggested

meaningful interpretations of it. (Petition, pp. 16-22.) Petitioner's unchallenged contention is that, contrary to Congressional intention, the decision below will continue to afford the Government's tax claims priority over the claims of general creditors in virtually every case.

The Government concedes that "the 1966 legislation was intended to strike a balance between achieving more effective rehabilitation of the bankrupt and more equitable distribution of the bankrupt's assets among his creditors, on the one hand, and the necessity of protecting the tax revenues, on the other." (Response p. 5) Yet, the Government argues for an interpretation of the statute under which it would continue to enjoy priority over general creditors in virtually every case. The Government's brief does not explain how that result would "strike a balance".

To permit an exception to swallow the rule is clearly improper, and in this case the result would be wholly to defeat the overriding purpose for which Congress enacted the 1966 amendments themselves.

2. This Is an Ideal Case by Which the Supreme Court Can Dispel the Increasing Confusion in the Lower Courts.

Since the filing of the Petition, the District Court has affirmed the decision of the referee in bankruptcy in *In re Michaud*, 24 AFTR 2d 69-5978, 1970-2 USTC ¶ 9658, (W.D. Pa. 1970), a decision which the Government concedes is inconsistent with the result reached below by the Fifth Circuit. The Government is appealing *Michaud* to the Third Circuit. If that court affirms, there will be a clear split in the circuits which the Supreme Court will have to resolve. In the meantime, there is intolerable uncertainty, attested to by the

fact that two of the three referees, and two of the three district courts that have confronted the question at issue have reached results contrary to that reached by the Fifth Circuit. Moreover, each of these two district courts has relied on a different proviso of exception (c) in reaching its result.

Rather than allow the present uncertainty to continue, the Supreme Court should act in the instant case. For, unlike *Michaud,* here both provisos of exception (c) are at issue and until both provisos are authoritatively construed the situation will remain hopelessly confused.

3. The Government's Assertion That an Assessment Could Not Be Made Until the Administrative Procedures Were Concluded Is Simply Wrong.

The Government asserts "that mailing of the deficiency notice effectively terminates the administrative proceedings before the Service . . . ." This grossly misstates the situation. In the overwhelming majority of cases, active settlement negotiations between the taxpayer and the Appellate Division and Regional Counsel of Internal Revenue continue after the case has been docketed in the Tax Court, often for protracted periods. In 1969 approximately 83 percent of the cases where Tax Court petitions were filed were settled prior to trial (1969 Comm'r of Int. Rev. Ann. Rep. p. 31).

The Government further argues that "in realistic terms, an assessment could not have been made until the bankrupt exhausted its administrative remedies . . . ." This is flatly untrue. Not only may an assessment be made if the Government fears an impending bankruptcy, but the Internal Revenue Code provides that the Commissioner *"shall"* make an immediate assessment

at any time "... he believes that the assessment or collection of a deficiency ... will be jeopardized by delay ...." I.R.C., section 6861(a). There was nothing whatever that prohibited the Government from mailing a 90-day letter at any time during the pendency of administrative proceedings, and thus it was not "by reason" of a prohibition that no assessment was made here prior to bankruptcy.

As a matter of actual practice, the Government never delays its assessment if there is any disadvantage *to the Government* in doing so. On the other hand, the Government customarily delays its assessment where the risk falls only on the general creditors, who have absolutely no way of protecting themselves from the Government's generosity. It was this practice which the 1966 Bankruptcy Act Amendments were intended to stop.

CONCLUSION

It should be re-emphasized that petitioner has not challenged the validity of waivers of the statute of limitations. Such waivers preserve the Government's claims, no matter how old. The only issue presented by this case is whether the Government is to be permitted to delay taking any steps to collect its taxes for an unlimited period of time and still claim priority over the general creditors. Even if the Government is denied priority as a result of the 1966 Bankruptcy Act Amendments, it will be entitled to share in the bankrupt's assets with the other general creditors. That is precisely the result intended by Congress. (See pet. pp. 14-15.)

Admittedly, the legislation is less clear than one would have wished. Petitioner's position is that there

are reasonable interpretations of the language in question which would effectuate the Congressional purpose. To permit the decision below to stand, will be tantamount to a total emasculation of the 1966 amendments, for if that decision stands the 1966 amendments will have accomplished nothing.

Respectfully submitted,

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